

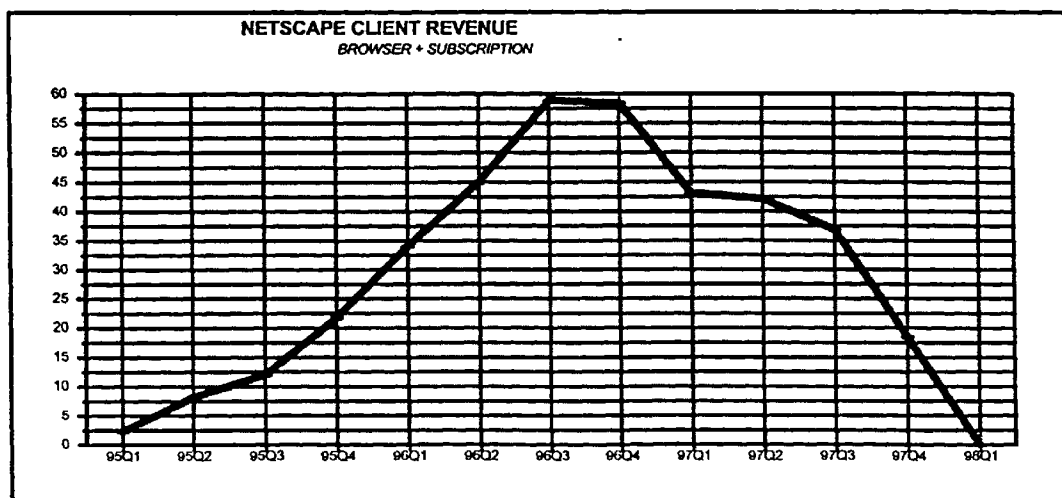
EFFECTS OF MICROSOFT CONDUCT

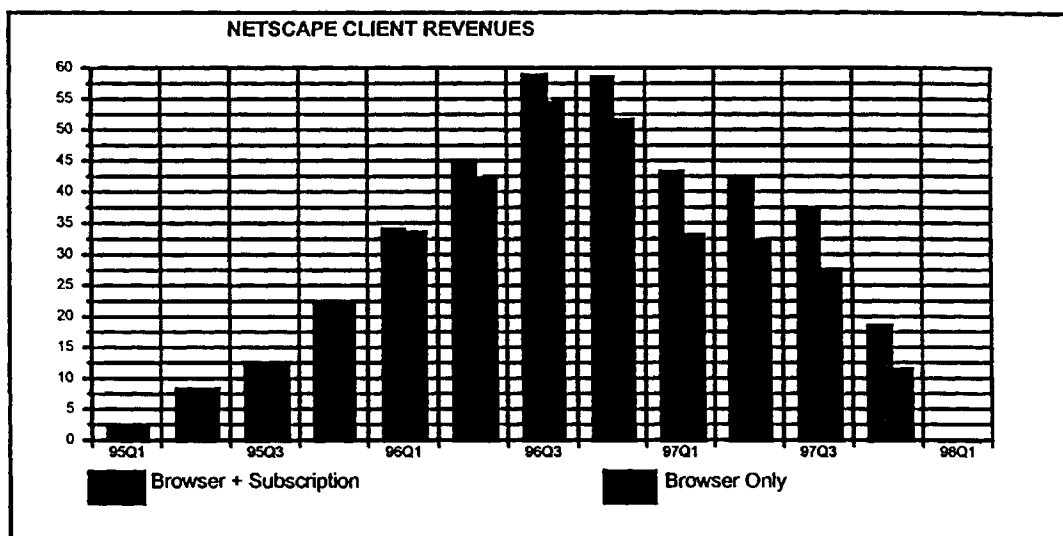
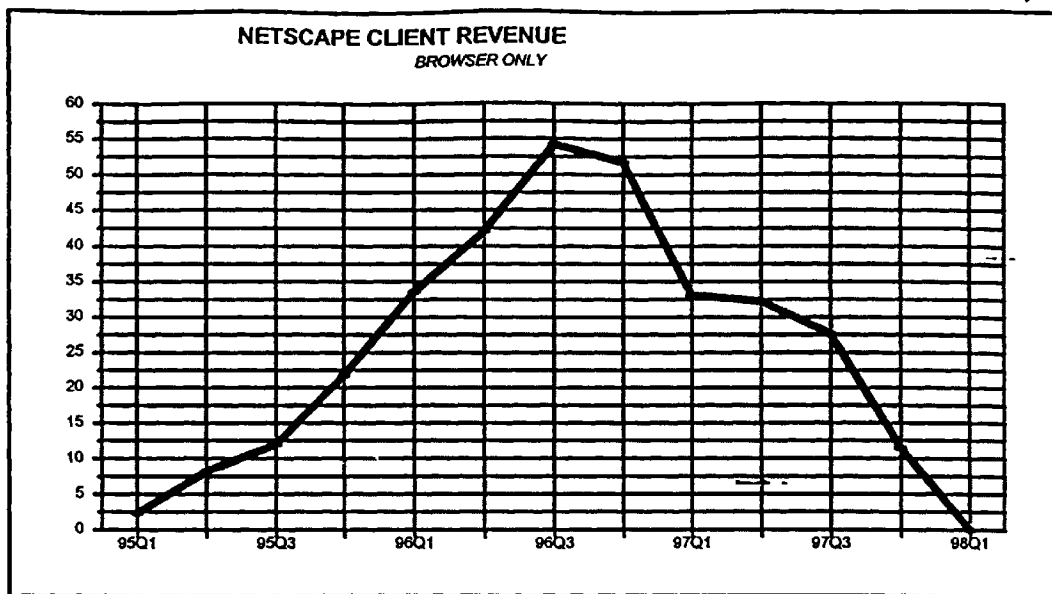
218. I have reviewed above numerous examples of Microsoft's anti-competitive conduct, including specific instances in which Netscape lost business because of Microsoft's exclusionary and predatory practices, pressure, and "better than free" offers. This conduct has had a serious detrimental effect on the ability of Netscape, or any other browser company, to compete, and it has limited consumer choice. The two most objective ways in which to measure the cumulative effect of Microsoft's conduct are through tracking revenue over time and tracking market share over time. The detailed discussion of each of these issues below clearly demonstrates that Microsoft's plan to "crush" Netscape in the browser space unfortunately is becoming increasingly effective.
219. **Revenue** – During 1995 and much of 1996, Netscape's primary revenues came from licenses of our browser. Those license fees escalated significantly, from \$2.3 million in the first quarter of 1995 to \$58.5 million for the fourth quarter of 1996, and were projected to continue trending upward. However, by 1997, Microsoft's constriction of Netscape's distribution channels had begun to reduce significantly our ability to receive revenues from new licenses of the browser. The following chart demonstrates the growth,

flattening, and decline of revenues from Netscape's browser through the first quarter of 1998:

1995	Q1	Q2	Q3	Q4
Browser + Subscription	\$2,326	\$8,245	\$12,010	\$21,779
Browser Only	\$2,326	\$8,245	\$12,010	\$21,779
1996	Q1	Q2	Q3	Q4
Browser + Subscription	\$34,072	\$45,052	\$58,867	\$58,466
Browser Only	\$33,557	\$42,130	\$54,248	\$51,710
1997	Q1	Q2	Q3	Q4
Browser + Subscription	\$43,145	\$42,112	\$36,869	\$18,523
Browser Only	\$33,119	\$32,247	\$27,635	\$11,523
1998	Q1	Q2	Q3	Q3
Browser + Subscription	\$0			
Browser Only	\$0			

220. These figures include licenses from Netscape Navigator and, beginning in June of 1997, Netscape Communicator. The total for "Browser + Subscription" reflects all revenues from stand-alone licenses of the browser plus revenue recognized from subscription fees under licenses from prior periods. The total for "Browser Only" reflects just revenues from stand-alone licenses of the browser, reflecting the new revenue-generating licenses entered into in a given quarter. Thus, "Browser + Subscription" is a trailing indicator, including revenues derived from past licenses, known as subscription fees which are allocated over different quarters for the length of the subscription; "Browser Only" more accurately demonstrates the precipitous decline in revenues from new browser licenses in each period. Both Browser + Subscription Client Revenue and Browser Only Client Revenue are plotted separately below, followed by comparison showing the more precipitous drop in new user browser licensing revenues:





221. In January 1998, as a result of Microsoft's actions, Netscape announced that it was making its browser available for free, and thus ceased receiving any material revenues from browser licenses.

222. **Market Share** – Netscape's browser market share has been dropping rapidly as Microsoft's exclusionary contracts and other predatory practices

took effect. According to the best data available to Netscape, our browser market share has dropped from over 70% in the first quarter of 1996 to approximately 40%-50%, currently, based on various studies. Moreover, these numbers understate the true effects of Microsoft's conduct, because our large installed base slows the statistical drop in overall market share, even as Netscape's market share of new browser users plummets. In fact, Netscape's share of new users has dropped much more significantly while Microsoft's share increased dramatically during the same period. Absent new developments, those numbers likely will result in further erosion of Netscape's overall market share as the installed base effect disappears over time.

223. The end result of Microsoft's practices is not just a drop in Netscape's market share and revenue; the end result, if Microsoft completely succeeds, is to deprive consumers of valuable innovations in this rapidly growing area of technology. Given that Netscape already has been forced to reduce its licensing fee to zero, it is deriving no revenue from browser licensing. Thus, although Netscape still chooses to invest in browser development, borrowing funds from other areas of the business, clearly this path will be difficult to sustain if Microsoft continues on its current path and accomplishes its goal.
224. Marc Andreessen recently found on the Internet an old letter written by Bill Gates in which Gates himself best described the effects on future innovation

of making software free -- what Microsoft began to do 20 years later. Back in 1976, when he and Paul Allen were just starting Microsoft, Mr. Gates wrote an "Open Letter to Hobbyists" relating to some improved versions of BASIC that he and Mr. Allen had invested \$40,000 in developing. Mr. Gates was apparently irritated that many software hobbyists were using his improved BASIC -- and liked it -- but were not paying the licensing fees. Mr. Gates wrote:

One thing you don't do by stealing software is get back at MITS for some problem you may have had. . . . One thing you do do is prevent good software from being written. Who can afford to do professional work for nothing? What hobbyist can put 3-man years into programming, finding all the bugs, documenting his product and distributing it for free? ("An Open Letter to Hobbyist," William Gates, III, February 3, 1996 as reprinted in the New York Times, July 23, 1997).

225. **Causes of Reduced Revenue and Market Share** -- There is no doubt in my mind that these drastic effects on our revenues and market share are the result of Microsoft's conduct described above. On the revenue side, all our browser revenue disappeared because it became increasingly difficult to charge for a product that our principal competitor was offering for free or "better than free," and we had been effectively locked out of the OEM and ISP distribution channels.
226. No other distribution channel today can make up for the loss of the OEM and ISP channels. While Netscape achieved significant successes in distribution

channels other than the OEM and ISP channels in the early years of the Internet, each alternative distribution method now suffers from several flaws or limitations.

227. Downloading is not an effective mass distribution mechanism today, because it takes a substantial amount of time and users have to be fairly sophisticated ~~actually~~ to download and install a browser. In the early days, most Internet users were quite sophisticated technically, and downloading a browser was feasible for them. Today's new users are, by and large, much less technically proficient, and the download process is daunting. While Microsoft has argued that statistics show that a significant number of people continue to download Netscape's products, these numbers need to be carefully evaluated, since the recorded numbers represent download attempts (many of which fail for technical reasons) and do not reflect whether that attempt resulted in the successful installation of a browser. In today's maturing Internet market, the OEM and ISP channels -- which are by far the easiest way for beginning users to obtain a browser -- have become the most important sources of current distribution.
228. Similarly, "carpet bombing" -- or mass distribution of unsolicited product -- is not an effective means of distribution for a browser company. First, it is extremely expensive. The high costs of carpet bombing do not make sense in the context of a software company that only earns a one-time fee for its

product, as opposed to an ISP that receives a monthly fee. Moreover, the high costs of carpet bombing are compounded by the fact that carpet bombing traditionally results in only a 1-2% adoption rate. Most unsolicited CD-ROM's end up in the trash, or as coasters that serve no purpose other than keeping the recipients' coffee cups from staining their desk. AOL is often cited as an example of successful carpet bombing. I would agree that the AOL carpet bombing experience was a success. However, AOL had to send out something like a billion -- 1,000,000,000 -- CD-ROM's to get something like a million subscribers. Moreover, AOL also gets a monthly subscription fee for its service, and thus has the potential to recoup its initial costs over time. For these reasons, Netscape has never carpet bombed and has no plans to do so in the future.

229. Netscape also distributes its products to some extent through ISVs, peripherals manufacturers, Value Added Resellers, or VARs, systems integrators and possibly others. Attempts to distribute through these alternatives to the OEM and ISP channels have been somewhat successful. However, that success must be put in context. Even a successful distribution arrangement with a peripherals manufacturers -- say, for example, a printer manufacturer -- will result in a very limited number of new browser users and is not going to make up for being excluded from distributing our product through the world's largest OEMs and ISPs.

230. In January of 1998, after we decided to make our browser free, we launched an "Unlimited Distribution" campaign, devoting tremendous resources to utilizing all available channels of distribution to increase our browser market share. While we obtained many new users from that effort, our overall market share has continued to drop. Unfortunately, this simply confirms my view that in today's market there is no substitute for the OEM and ISP channels of distribution, which Microsoft has largely blocked through the predatory conduct discussed above.
231. Microsoft has publicly alleged that Netscape's loss in revenue and market share is a result of our failure to innovate. Nothing could be further from the truth. Netscape has been and continues to be a market leader with regard to browser innovations. Indeed, the 1.0 release of Navigator delivered incomparably better performance than other browsers available at the time. Its innovative capabilities included continuous document streaming, enabling users to interact with documents while they were still being downloaded rather than waiting for the entire document to load; multiple network accesses, allowing several documents or images to be downloaded simultaneously; native support for the JPEG image format; and security features such as encryption and server authentication.
232. Of course, because Navigator was available seven or eight months before Internet Explorer and before, to my knowledge, Microsoft had even

formulated its Internet strategy, Microsoft had a target to shoot for with its first release. Microsoft did not hit that target. Microsoft's 1.0 release of Internet Explorer was substantially inferior to Navigator's 1.0 release.

233. At the same time Microsoft was releasing Internet Explorer, Netscape was well on its way to its 2.0 release of Navigator. Navigator 2.0 and Internet Explorer 1.0 overlapped in the market for some period of time until Microsoft released Internet Explorer 2.0 in December of 1995. Again, reviews consistently ranked Netscape Navigator 2.0 as superior to Microsoft's later Internet Explorer 2.0 release.
234. What is most significant about Navigator's superiority to Internet Explorer during this period is that, even though Navigator's superiority was unquestioned by independent analysts and the public, Microsoft was able to begin gaining substantial market share at this time through its forced bundling with Windows 95, its exclusive deals, and other predatory practices.
235. Microsoft did not reach parity with Navigator 3.0 even as of the release of Internet Explorer 3.0 in August of 1996. Netscape had the lead in numerous important areas. These included LDAP and e-mail features, HTML composition, calendaring, cross platform support, open standards support, content security, HTML and VRML rendering performance, web site integration, memory utilization, stability, compatibility with other Windows applications, plug-in support, and download size.

236. The 4.0 release of Internet Explorer in September of 1997, released after Netscape's Navigator 4.0, was the first time that Microsoft reached anything resembling a level of parity with the then-current release of Navigator. The features and functionality of Navigator 4.0 and Internet Explorer 4.0 are similar, and the two products have both received positive reviews. While we believe our product is better, new users are unlikely to undertake a meaningful comparison if the only browser they receive, by virtue of bundling or exclusive arrangements with OEMs and ISPs, is Internet Explorer.
237. Although both Microsoft and Netscape's products recently have received favorable and comparable reviews, one influential reviewer, CNet, reversed its review in favor of Internet Explorer and chose Navigator 4.0, citing security and stability problems with Internet Explorer 4.0. ("Battle of the Sumo Browsers," CNet, by Rex Baldazo, 9/29/97, updated 10/17/97; updated 2/18/98 and 4/2/98 by Cormac Foster.). Indeed, even Microsoft's Steve Ballmer acknowledged that significant quality issues have been raised about Internet Explorer 4.0. ("Ballmer: IE4.0, A Trade Off," CNet, December 5, 1997).
238. Microsoft publicly has claimed that Internet Explorer 4.0 won 19 out of 20 head-to-head reviews against Navigator. Because I was generally familiar with the reviews at the time that Microsoft made this statement and, based on my knowledge of those reviews, believed it to be false, I commissioned

some research to be done regarding the veracity of Microsoft's contention.

The researcher did not even find 20 reviews in which the products were reviewed head-to-head. Of the handful of reviews that did look at the products head-to-head, the results were a mixed bag. Some reviewers preferred certain features of Internet Explorer over Navigator and some preferred certain features of Navigator over Internet Explorer.

239. Microsoft also has suggested that Netscape's loss of market share is due to its own "bad" corporate decisions. Sure, I agree we may have made some decisions that in hindsight I might not have made, but so has every company, including Microsoft. Indeed, when the Internet revolution began -- a revolution based on open standards and open access to all -- Microsoft was spending hundreds of millions of dollars developing and marketing its proprietary on-line service called the Microsoft Network ("MSN"). MSN, by all accounts, did not succeed, and Microsoft was forced to play catch-up in the already exploding Internet marketplace. In a competitive market, a company frequently can recover even from a major strategic mistake, like Microsoft's. However, in a market being targeted by a monopolist, such as Microsoft, even a routine misstep can be devastating. Moreover, no matter how a competitor attempts to adjust to the monopolist's predatory practices, those practices clearly will have a detrimental effect. Indeed, they did. No matter how Netscape adjusted, we ultimately had to abandon our business model, forego

all browser revenue, and formulate and implement a new business model in a short period of time. This has been a difficult mission. Even now, with Netscape's new business model, Netscape is getting reports of Microsoft targeting its new business plans. Indeed, as recently as September 21, 1998, Netscape learned that a European Internet Content Provider could not post a Netscape downloading button because the Content Provider was prohibited from doing so by its contractual obligations to Microsoft. Moreover, even after Netscape began giving its browser away for free in early 1998, Netscape continues to lose market share to Microsoft. This poses a problem for Netscape because, even though it has shifted its business strategies, our browser is important to continued brand recognition and constitutes a significant avenue for distribution and promotion of other Netscape products and other important technologies, such as Java.